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Reforming Canada's Financial Services Sector

A Framework for the Future

Statement by the Honourable Paul Martin
Minister of Finance

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Canada

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Distribution Centre
Department of Finance
300 Laurier Avenue West
Ottawa K1A 0G5

Telephone: (613) 995-2855
Facsimile: (613) 996-0518

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Ladies and gentlemen,

I am here today to announce the government's new policy framework for the financial services sector, a framework for which we intend to table legislation in the House of Commons as soon as is feasible.

I would like to begin by expressing my gratitude to the members of the Task Force on the Future of the Canadian Financial Services Sector for their invaluable work.

I would also like to thank the members of the two parliamentary committees that studied and debated the Task Force report, as well as the many stakeholders who actively participated in the process – a process that was launched in December of 1996.

Finally, I would like to express my appreciation to the officials at the Department of Finance, the Bank of Canada, the Office of the Superintendent of Financial Institutions and the Canada Deposit Insurance Corporation, who have put in countless hours in the development of this framework.

It is as a result of all their work that we are able to release on behalf of the government a document that contains a comprehensive, fair and balanced package of reforms, one that is good for Canadians and good for the financial sector itself.

Background

We – all of us – are part of the information revolution. The forces of globalization and the massive, rapid impact of applied technology have effectively shrunk the planet.

This has created many exciting opportunities, but it also creates new challenges.

As a society, we must respond to these challenges head-on if we are to be able to seize the tremendous opportunities they offer.

Nowhere is this more evident than in financial services.

The incredible increase in computing power and the decrease in costs have meant that products and services – from automated tellers to Internet banking – can be delivered at low cost to the remotest corners of the country and the world.

Our financial institutions are among the most innovative and dynamic companies anywhere, but as the global environment changes, there is an ever-increasing need for them to evolve and adjust.

In this environment, the government's role is to ensure that Canada has an appropriate policy framework to facilitate change and to provide ground rules to ensure that it takes place in a way that reflects the needs of all Canadians.

To this end, during the last two years, we have listened carefully to the views of consumers, businesses large and small, and our financial institutions.

The time has now come to act.

Our new policy framework is based on four fundamental principles.

First, banks, trust companies, credit unions, insurance companies and other financial institutions must have the flexibility to adapt to the changing marketplace, and to compete and thrive both at home and abroad.

Second, vibrant competition in the financial services sector is necessary to allow consumers and businesses alike to benefit from a wide range of choice at the best possible price.

Third, consumers, regardless of their income, whether they live in an urban or rural area, and individual businesses, be they large or small, should receive the highest possible standard of quality and service.

Fourth, the regulatory burden should be lightened wherever possible, consistent with prudential and public interest concerns.

Promoting Efficiency and Growth

A strong, efficient and profitable financial services sector is vital to Canada's economic well-being. The sector is a major contributor to job creation, export growth and tax revenues.

Our financial institutions have an impressive history. They are well run. It is important that they have the opportunity to grow and prosper.

Over and above their direct contribution, financial institutions are involved in virtually every transaction in the economy – processing payments, pooling savings, financing investment and managing risk.

The men and women who work in Canada's financial institutions are the people Canadians turn to for financial services and advice, and the success of each institution depends on them.

Every day, for example, banks and their employees are faced with new and ambitious competitors offering new products and services. And many of these are unregulated, or less tightly regulated, than banks, trust companies or insurance companies.

This presents a formidable challenge for Canadian financial institutions; one that can be compounded by a rigid structural framework.

That is why we must ensure that they have the organizational flexibility necessary to adjust to a changing marketplace and to provide a greater range of products and services at competitive prices.

This is the basis for the measures we are announcing today.

Holding companies – promoting greater flexibility

We will increase organizational flexibility for our financial institutions by introducing a new holding company option.

A holding company will allow banks, for example, to place certain activities such as credit cards in affiliates outside of the bank itself. Regulation of such affiliates will be generally lighter than that applied overall to a fully regulated bank.

It will also give our financial institutions greater flexibility in competing with unregulated institutions and those that specialize in a single line of business.

Facilitating strategic alliances and joint ventures

At the present time, banks are precluded from entering into joint ventures and forming strategic alliances that would result in any shareholder having more than 10 per cent of the bank's shares.

This restriction was put in place to ensure that our largest banks were widely held.

After 30 years of experience with this regime, we believe we can now have more flexibility to accommodate these kinds of ventures and alliances.

To do that, and to complement the holding company structure, we will be raising the 10-per-cent widely held limit to 20 per cent. In addition, we will be raising the limit to 30 per cent for non-voting shares.

However, we continue to believe that allowing a single party or group of investors to control a large bank is contrary to sound prudential practices.

Therefore, the government will review the existing provisions of the *Bank Act* which prevent any one interest from having direct or indirect control of a bank, to ensure they are adequate to preclude control by a shareholder or group under the new ownership rules.

Taxation – the use of capital taxes

The government recognizes that taxes on capital are an important element in determining the competitiveness of our banks.

We also recognize that, in this important field, the federal government shares responsibility with the provincial governments.

For this reason, the government will raise with the provinces the effects of capital taxation on the financial services sector.

As part of these discussions, we are committing today to re-examining our own capital taxes.

Merger Review Process – increasing transparency and public participation

As promised last December, we are also announcing a new review process for mergers between large banks.

This is intended to bring clarity and to take into account public interest considerations.

In the future, merger proponents will be required to produce Public Interest Impact Assessments that the House of Commons Standing Committee on Finance will be asked to review.

Concurrently, the Office of the Superintendent of Financial Institutions and the Competition Bureau will conduct their own reviews with respect to potential prudential and competition concerns.

They will provide their reports to the Minister of Finance, who will make them public. As well, the Finance Committee will have the opportunity to take both documents into account.

After reviewing the advice of all three parties, the Minister will decide whether the proposed merger gives rise to any concerns.

In the event these concerns cannot be satisfactorily addressed, the transaction will be turned down. If, following a negotiation, the proponents were prepared to accept terms and conditions determined by the government, a transaction could be approved.

Fostering Domestic Competition

Consumers are the principal beneficiaries of vibrant competition because it is the key to quality, price and choice of financial services for Canadians.

The Canadian financial services sector is already quite competitive with a wide range of services and suppliers available to both businesses and consumers.

But the Task Force also found that because of barriers to entry and industry consolidation, there is still room for increased competition within the sector.

One way to provide a competitive environment is to encourage the growth of a healthy second tier of deposit-taking institutions – that is, smaller financial institutions that compete with the large banks in regional or local markets.

New ownership rules – permitting new entrants

As I have indicated, our current ownership rules were intended to preserve the safety and soundness of the system.

Over time, however, this policy has limited the number of new entrants into the banking sector, thus affecting competition.

New ownership rules are required to allow banks more flexibility and also to foster greater competition in the banking sector.

Therefore, we will now allow an individual or a corporation to own all of the shares of a bank, as long as that bank has less than $1 billion in equity.

That is to say, single ownership of small banks will be permitted.

We will also give banks with equity between $1 billion and $5 billion the option of being closely held, provided they have at least a 35-per-cent public float.

This policy change will allow companies, for instance, those with a network of stores or outlets, to own banks.

For existing Schedule I banks with equity under $5 billion, their widely held status will be maintained.

However, we recognize that there may be circumstances where it could be advantageous for one or more of these banks to consider a closely held structure.

Therefore, if requested, the Minister of Finance will have the discretion to change the status of these banks to the new regime.

To further encourage new entrants, we will lower the minimum capital requirement from $10 million to $5 million, thus facilitating entry into banking by individuals or smaller companies.

These policy changes will facilitate the establishment of "community banks," that is to say, small, local institutions whose services are tailored to the needs of a specific community.

Now, we recognize that increased competition can sometimes lead to increased risk.

That is why we will also enhance the 1995 regime of early intervention, closure and self-dealing by making improvements to prudential regulation to minimize the potential increase in risk.

The measures we are putting forward to facilitate entry into the banking sector build on the government's important foreign bank branching initiative, which received Royal Assent last week.

Demutualized insurance companies – increasing growth opportunities

Earlier this year, Parliament also passed legislation to allow federally incorporated mutual life insurance companies to convert into stock companies.

This regime is intended to give these institutions the ability to structure themselves in a more flexible manner.

Following demutualization, a company will have a two-year transition period during which it will continue to be widely held and will not be allowed to merge or be acquired.

At the end of the two-year period, large demutualized companies, those with over $5 billion in equity, will be required to be widely held, with the same ownership limitations as large banks.

However, those with equity between $1 billion and $5 billion will be allowed to be closely held but will be subject to a 35-per-cent public float requirement.

Institutions with less than $1 billion in equity will not face any ownership restrictions.

Caisses populaires and credit unions – towards a national presence

We will also introduce measures to enhance the caisses populaires and credit union movements, a very important segment of the Canadian financial services sector.

Indeed, one study has found that, in roughly 1,000 communities across Canada, credit unions and caisses populaires are the sole financial institution.

Right now, the fragmented nature of the credit union system outside of Quebec makes it difficult to raise capital and to co-ordinate the use of available resources within the system.

We believe that an enhanced co-operative movement could play a key role in strengthening the second tier of institutions in Canada and, in doing so, foster greater competition in our financial services sector.

That is why we have responded positively to recent proposals advanced by the credit union movement.

Chief among these is an initiative spearheaded by the Credit Union Central of Canada to permit credit unions to reduce costs, eliminate duplication, promote stronger co-ordination and create national brands, all with a view to establishing a stronger national presence.

To facilitate this, we intend to bring forward the necessary legislative amendments to provide credit unions with new ways to operate in a cohesive manner and on a truly national basis.

This will allow the credit unions to compete better with larger institutions, both domestic and foreign.

In addition, several of the country's largest credit unions would also like to be able to form a national co-op bank.

While the proponents of this initiative have not yet determined which structure would best allow them to meet their ambitions, the government will work with them and any others who are interested over the next several months to explore how it can best accommodate their plans.

Opening up the payments system – promoting competition

Competition is also affected by access to the payments system because it is the means that makes it possible for a variety of financial instruments to be exchanged in the economy for goods and services.

This is the system that enables cheques and other methods of payment to be used in transactions throughout the economy.

By providing increased access to the payments system to regulated financial institutions such as life insurance companies, money market mutual funds and securities dealers, we can expect to see an increase in the number of financial services that have the same basic attributes as chequing accounts.

This will give consumers more choice in selecting the kind of institutions that can hold their funds, while still giving them the convenience of ready access to their money.

Empowering Consumers

While competition is an important force that works to the benefit of consumers, it alone cannot guarantee that they are adequately represented and protected.

Globalization and technological innovation offer both greater convenience and increased choice to consumers by allowing them to access electronically the information they need to compare services anywhere in the world.

At the same time, however, the marketplace can become more complex as the choice of products and services increases.

This can result in an imbalance in the relationship between consumers and their financial institutions.

We need to help guard against this imbalance by clearly identifying areas of responsibility for consumer protection and by putting a framework into place to ensure it.

To be effective, any consumer protection regime must have three equally important components: an assurance that all Canadians get fair access to banking services; credible and accessible oversight and redress mechanisms; and strong consumer safeguards, including an accountability framework.

As well, however, it is incumbent upon us to achieve these objectives without placing an undue burden on our financial institutions.

Ensuring access to necessary services

When dealing with financial services, access is a primary concern – access to basic services, to accounts and to branches.

Access is a special concern for seniors, for Canadians with disabilities and for Canadians with low incomes.

We will table legislation to ensure that all Canadians have access to basic services by specifying in regulation identification requirements that are sufficient to open a bank account and to ensure that employment is not a condition of opening one.

The legislation will also ensure that banks offer a standard low-cost account with a maximum fee and a reasonable number of services attached to them, including in-branch banking.

This is of particular interest to seniors.

Our banks should be commended for the progress they have made in improving physical access to branches for persons with disabilities. Going forward, we will work with our banks and other financial institutions to explore how we can do more in this area.

In regard to closures of branches of deposit-taking institutions, we will implement a two-tier regime designed to give communities the time needed to react and adjust.

As a general rule, a deposit-taking institution will be required to give four months' notice of its intention to close a branch.

But if it is the last deposit-taking institution in the community, the notification period will be extended to six months.

This framework recognizes the need for consultation and community involvement to explore alternative arrangements when a branch closes. It also acknowledges the responsibility that institutions bear in facilitating adjustment to the change.

In addition, the government will require federally regulated financial institutions above $1 billion in equity to publish annual Public Accountability Statements describing their contributions to the wider community.

The Statements will also include their progress in meeting the needs of specific groups through such initiatives as improving access to banking services for low-income individuals, seniors and people with disabilities.

Establishing a Financial Consumer Agency

Today, we are also acting to implement an oversight regime to hold financial institutions accountable through regulatory and self-regulatory measures.

We will be establishing a new Financial Consumer Agency to consolidate and strengthen existing oversight activities currently dispersed among various federal entities.

The Agency will be responsible for administering federal consumer protection legislation in the area of financial services.

The new Agency will also monitor and report on compliance by financial institutions with legislative requirements and self-regulatory initiatives, as well as promote industry best practices and provide consumer education and information.

The creation of this Agency reflects the government's view that consumer protection, together with the prudential regulation undertaken by the Office of the Superintendent of Financial Institutions, is integral to the necessary oversight by the government of the financial sector.

Creating a Canadian Financial Services Ombudsman

For those who have individual complaints and who believe that they have been treated unfairly by their financial institution, an independent Canadian Financial Services Ombudsman will be established.

This will ensure that an appropriate and accessible redress mechanism is in place to give Canadian consumers and small business the ability to present their views to an independent and objective third party.

As requested by a number of consumer and business groups, we are opting for a model where the ombudsman continues to operate independently from government in order to encourage as wide a membership as possible.

A Board of Directors, of which two-thirds of the members will be independent from the industry, will govern the office of the ombudsman.

Banks will be members of this new ombudsman system.

For federally regulated insurance and trust companies, authority over whom we share with the provinces, the law will require that they be members of a third-party dispute resolution system.

We strongly encourage them to choose membership in the new financial services ombudsman to meet this requirement.

Provincially regulated financial institutions will be able to join on a voluntary basis.

Providing additional safeguards and accountability

Today's package of reforms also contains initiatives with respect to tied selling and public accountability.

More specifically, we will expand the *Bank Act* provisions to prohibit coercive tied selling beyond loan products to include a tied sale between any two or more products.

The government will also provide leadership in identifying best disclosure practices, for example, by working with provinces and stakeholders in modelling plain language documents and by benchmarking the industry's practices.

Business powers

In terms of business powers, the government agrees with the House of Commons Standing Committee on Finance that bank powers should not be expanded in the areas of insurance retailing and car leasing at this time.

Adjusting the Regulatory Framework

Canadians benefit from a safe and sound financial services sector that is the envy of the world.

One of the keys is a regulatory framework that is strong and responsive to change.

Another is one that balances the need to lighten the regulatory burden on the one hand, with prudential and public interest objectives on the other.

We will introduce a number of measures to improve the effectiveness of the regulatory system, including significant improvements to the governance and oversight of the Canadian Payments Association.

Conclusion

In summary, we believe this new policy framework is fair and balanced.

We believe it will be good for Canada and Canadians, and good for the financial services sector itself.

It is a framework that will give Canada's banks greater flexibility in adapting to the changing business environment, including greater potential for strategic alliances and a new holding company option with the potential for lighter regulation. As well, there will be a new Merger Review Process, the intention to review capital taxes with the provinces and streamlined regulatory processes.

Our life insurance companies will benefit from a new holding company option and streamlined regulatory processes, and they, along with securities dealers and money market mutual funds, will benefit from access to the payments system.

Canada's credit unions will be able to form a National Service Entity and possibly a national co-op bank. They will then have the ability to better compete with large deposit-taking institutions.

The framework gives consumers guaranteed access to standard low-cost accounts, a reasonable process to adjust to branch closures, increased competition for their business, the assurance that financial institutions adhere to consumer protection policies, and access to an independent ombudsman to ensure that they are treated fairly.

Small and medium-sized businesses will benefit from increased choice among financial service providers and an independent ombudsman. There will also be more comprehensive data on small-business lending and a new analytical group at Industry Canada to ensure a better understanding of their financing needs.

Our goal is to provide Canada's financial institutions with an environment to stimulate economic growth and innovation in the interest of all Canadians.

The course of action we have set out today meets that commitment and creates a framework that positions Canada's financial services sector for the 21st century.

Thank you.